

A political decision was taken by Council in October 2014<sup>1</sup> to continue allocating allowances free of charge in Phase 4 of the EU ETS to protect certain sectors from the assumed risk of carbon leakage. However, that decision can translate to **many highly emitting sectors receiving more free allocation at the start of Phase 4 than they receive at the end of Phase 3.**

As illustrated in Chart 1 below, our free allocation [model](#) (which now applies updated emissions and trade intensities for several of the main emitting sectors) indicates that free allocation in 2021 is likely to increase from the 2020 level for many sectors. Rebasing the cap secures greater environmental integrity to the overall system without significant tightening in free allocation from 2020 to 2021.

### About Sandbag

Sandbag is a London and Brussels-based not-for-profit think tank conducting research and campaigning for environmentally effective climate policies.

Our research focus includes reforming the EU Emissions Trading System and the Effort Sharing Decision; accelerating the phase-out of old coal in Europe; deep decarbonisation of industry through technologies including Carbon Capture & Storage.

For more information, visit [sandbag.org.uk](http://sandbag.org.uk) or email us at [info@sandbag.org.uk](mailto:info@sandbag.org.uk)

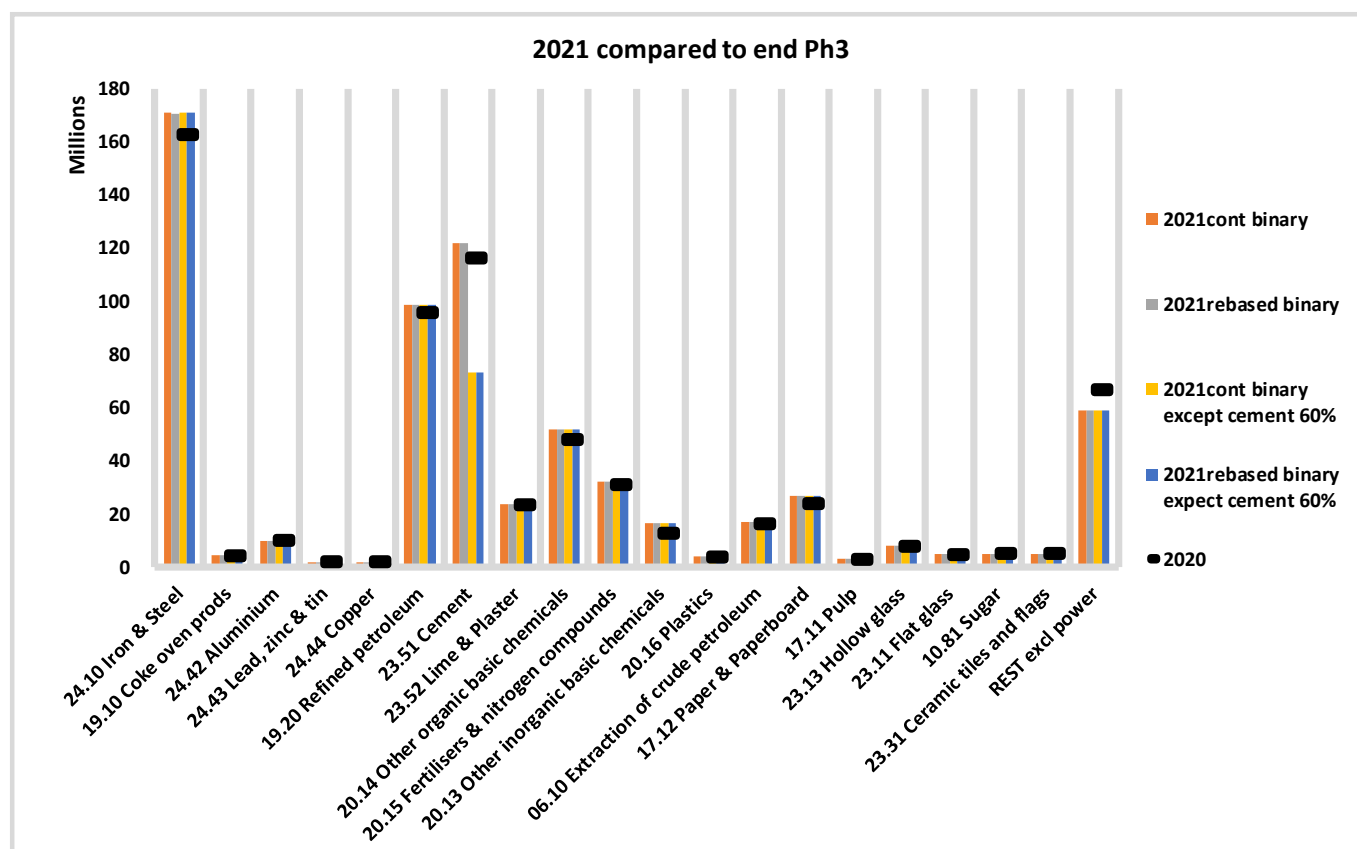


Chart 1. 2021 free allocation (tCO<sub>2</sub>e) under different cap setting and carbon leakage protection approaches (with -1% benchmark reductions across all sectors, 2.2% LRF, 57% auction share, binary threshold of >= 0.2 for 100% of benchmark and rest at 30%, and maintaining current activity levels); compared to 2020 free allocation

<sup>1</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/145397.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/145397.pdf)

Chart 2 (below) illustrates the reduction in average free allocation across the whole of Phase 4 compared to 2020 for the main emitting sectors meeting the binary carbon leakage criterion of 0.2. Even under a rebased cap, the average Phase 4 free allocation is reduced by less than the EU wide ETS decarbonisation trajectory for most of these sectors.

Specifically, the average total cap across the whole Phase 4 is 14.6% below the 2020 cap. With rebasing the average total cap is 21.6% below the 2020 cap. In contrast, even with rebasing the average free allocation across the Phase for most of the main emitting sectors would be less than 15% lower than 2020 allocations - a reduction of less than 1.5% per year. (The reduction trajectories for these sectors would be even slower, and even result in an increase compared to 2020 for a couple of sectors, if the carbon leakage risk for the cement sector were to be handled via complementary measures with a 60% of benchmark free allocation instead of 100% of benchmark free allocation.) This needs to be put into the context of a total cap LRF of 2.2% for Phase 4 and 1.74% for Phase 3. Thus, **the reduction in free allocation for these main industry sectors would be less stringent than the overall cap.**

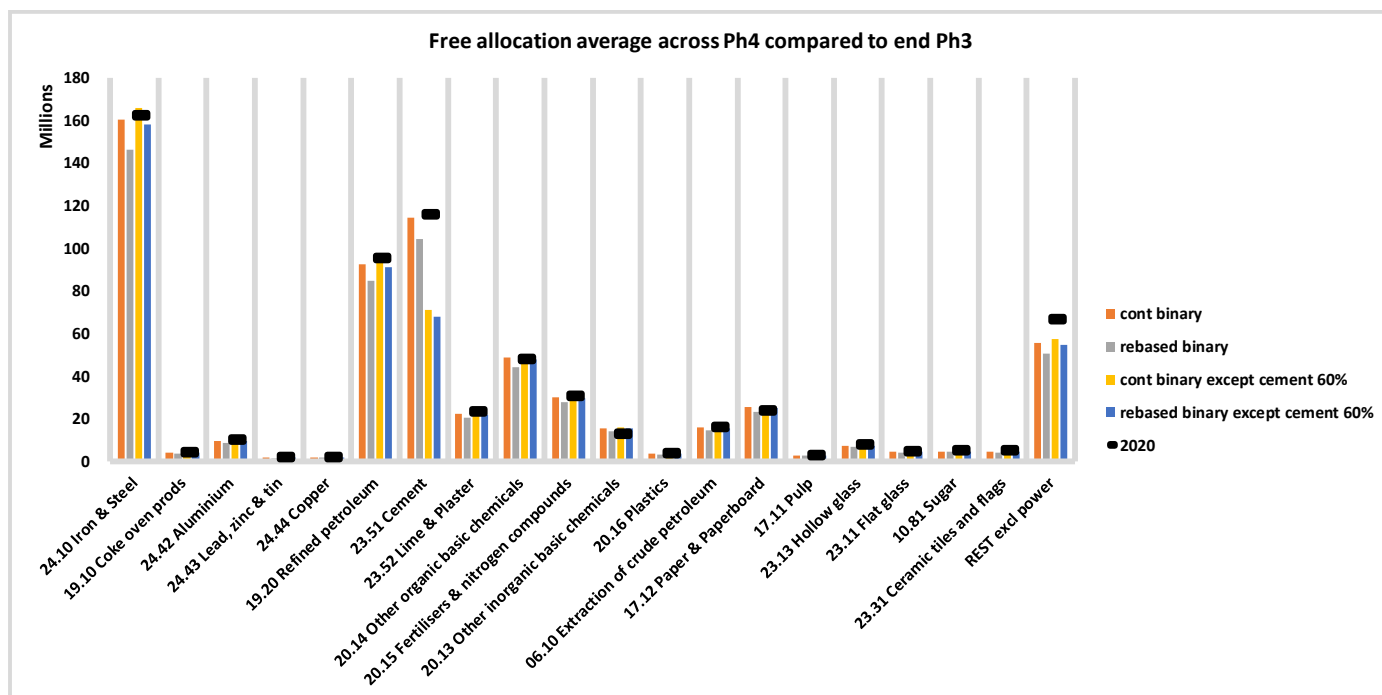


Chart 2. Average Phase 4 free allocation (tCO<sub>2</sub>e) under different cap setting and carbon leakage protection approaches (with -1% benchmark reductions across all sectors, 2.2% LRF, 57% auction share, binary threshold of >= 0.2 for 100% of benchmark and rest at 30%, and maintaining current activity levels); compared to 2020 free allocation

Emission trading is intended to reward best performers through avoided carbon cost, and through trading of permits with other participants who calculate they can meet their carbon obligations most cost effectively by buying permits rather than by investing in their own plant. If the most highly emitting industry sectors all continue to receive high levels of free allocations (covering their needs up to the level of the best performing players in their sector) there is less incentive to improve the current technologies. Scale-up of new alternative technologies and low carbon products may be delayed by the absence of a significant carbon penalty for old technology emitters.

**We are living in a carbon constrained world. European industry must play its part. How can we expect other jurisdictions to adopt stringent transitional free allocation measures if we accept an EU reform that increases free allocations for main emitters from the end of one phase to the start of the next?**